No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY; TAPOCO, INC.; AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL; ET AL.,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE STATE OF TENNESSEE AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

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QUESTIONS PRESENTED

1. Whether under the Commerce Clause a state, in setting retail electric rates within its borders, may give its citizens a preference to the inexpensive hydroelectric power generated and consumed in a multistate area?

2. Whether one state, in regulating retail electric rates within its borders, may set aside the interstate allocations of wholesale power and costs established by the Federal Energy Regulatory Commission, and impose a different allocation of costs which is more favorable to its own citizens?

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In accordance with this Court's Rule 36, the State of Tennessee, through its Attorney General, W. J. Michael Cody, and on behalf of its Department of Economic and Community Development, submits this brief as amicus curiae in support of appellants, Nantahala Power and Light Company; Tapoco, Inc.; and the Aluminum Company of America. Authority for the filing of the brief is found explicitly at Supreme Court Rules 36.2 and 36.4.

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INTEREST OF THE STATE OF TENNESSEE AS AMICUS CURIAE

This case concerns the basic design of our federal system of government and the relationship of the states to each other and to federal authority. It involves the rights of the State of Tennessee and of its citizens within that framework. Tennessee has a vital interest in this case, both for jurisdictional reasons and because of its immediate impact on the economy of the State and the livelihoods of its citizens. The decision of the court below, if left undisturbed by this High Court, will result in North Carolina's having the final authority to control the supply of electricity in Tennessee, without Tennessee's having any meaningful role in the decision-making process. As a result of the parochial decision made in North Carolina, Tennessee will suffer serious economic dislocations. If the Aluminum Company of America plant in Blount County, Tennessee is deprived of the inexpensive power that North Carolina has appropriated for itself, then the Tennessee facility may well be so uneconomical, in the power-intensive aluminum industry, that it will be forced to close. This would produce severe economic problems in Blount and surrounding counties in East Tennessee, whose industrial base for most of this century has been fashioned around the Alcoa plant. Closing of the plant would cause the immediate loss of approximately four thousand jobs at the Alcoa facility alone, as well as additional thousands of related jobs in the area.

The decision of the North Carolina Utilities Commission, as upheld by the North Carolina Supreme Court, would divert from Tennessee to North Carolina the economic benefits of inexpensive hydroelectric power previously allotted to Tennessee by the Federal Energy Regulatory Commission (FERC). This diversion has been accomplished under the guise of a local ratemaking proceeding in North Carolina, but that makes its effect no less grievous. The peculiar roll-in device utilized by the North Carolina Commission has the direct practical result of overturning the allocation of this power established by the FERC, which regulates the interstate flow of the power resources and associated costs in the region.[1] The North Carolina Commission has done this without considering the needs of Tennessee or its rights under FERC-approved rate schedules, determining instead that North Carolina customers are entitled to a "first call" preference on the inexpensive power resources of the Southern mountains.

Consequently, Tennessee is intensely interested in the outcome of this litigation, believing that adherence to FERC's objective allocation of power and costs will prevent the economic devastation of mid-East Tennessee. This case ought to establish the important principle that one state cannot ignore and wholly supersede the allocation of power and costs among separate states as determined by the FERC. In view of North Carolina's clever attempt to do so, the outcome of this case will have a profound impact in Tennessee.

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[1] The only exception to FERC regulation relates to the Tennessee Valley Authority (TVA), a major supplier of electric power in the region. As a federal government corporation, TVA, under the terms of its enabling statute, establishes its own rates. *See* 16 U.S.C. § 831k.

SUMMARY OF ARGUMENT

Tennessee submits that the decision below is a brazen attempt by North Carolina interests to acquire the benefits of hydroelectric resources properly belonging to Tennessee, without allowing Tennessee an impartial forum in which to assert its claims. In the form of a state commission retail ratemaking proceeding, North Carolina has effectively usurped the role of the FERC and flouted its authority. The decision below violates the Commerce Clause by giving first preference to narrow state interests over those of other states and the broad national economy. It violates the Federal Power Act by rendering meaningless the FERC's allocations of power and costs in the mountain region. Basic notions of federalism guarantee Tennessee a fair and impartial forum and certainly establish that a North Carolina agency cannot, under any guise, determine the interstate allocation of resources. Thus the decision of the North Carolina Supreme Court must be rejected in its entirety.

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ARGUMENT

NORTH CAROLINA, UNDER THE GUISE OF A LOCAL RATE-MAKING PROCEEDING, MAY NOT SET ASIDE ALLOCATIONS OF POWER AND COSTS ESTABLISHED BY FERC AND GIVE ITS CITIZENS PREFERENCE TO THE POWER RESOURCES OF A MULTISTATE AREA.

I.

BACKGROUND

Tennessee shares with North Carolina and other states the power resources of the southern Appalachian region, including a number of hydroelectric generation sites. A portion of the inexpensive hydroelectric power generated in North Carolina and Tennessee historically has been supplied by Tapoco, a Tennessee company, to one of Tennessee's large industrial power consumers, the Aluminum Company of America plant at Alcoa, Tennessee. Tapoco's use of this hydroelectric power to serve the Alcoa facility has been approved by the Federal Energy Regulatory Commission (FERC), the federal agency having exclusive jurisdiction over wholesale electric rates and the allocation of wholesale power among states.

Alcoa has played a major role in the economic development of the mountain region since its entry in o the area in the early 1900's. Its participation led to the harnessing of the rivers of the region at an early date, to the benefit of the consuming public as well as itself. Alcoa's Tennessee Operations constitutes one of Tennessee's largest and most valued employers, providing jobs for approximately 4,000 citizens and greatly enhancing the economic

wellbeing of East Tennessee. The lifestyle of several substantial cities, as well as the tax base of the region, is dependent on the economic viability of the Alcoa plant. That plant, in turn, depends on a supply of relatively inexpensive hydropower to blend with more costly TVA power, in order to exist in a competitive environment. Until now, that power supply was assured by allocations of the FERC.

In the instant case, however, the State of North Carolina, through its Utilities Commission, has for all practical purposes overruled the FERC and adopted a new method of distributing power costs in the southern mountain region. It has used as a convenient vehicle the fact that Nantahala Power and Light Company, the utility serving consumers in western Carolina, and Tapoco, Inc., the utility serving the Alcoa plant in Tennessee, are both subsidiaries of Alcoa. While North Carolina's actions take the form of establishing retail rates in that state, the peculiar roll-in device used by the Utilities Commission produces a complete usurpation of FERC regulation. Moreover, when combined with the unjustified presumption that all the inexpensive power should first go to serve the North Carolina public load, the result effectively deprives Tennessee of the protection of FERC's impartial ratemakers.

The result is that Tennessee and one of its most important industrial facilities will be deprived of the benefits of the portion of the inexpensive hydropower allocated to them by FERC. This has been accomplished wholly through ratemaking proceedings in the agencies and tribunals of North Carolina, which are charged under North Carolina law with promoting the interests of North Carolina citizens. Whatever the institutional leanings of the

North Carolina regulatory process, Tennessee has had no opportunity to participate in the decisions at issue. The North Carolina tribunals have acted without regard for FERC's findings, which were derived from proceedings that took into account all the interested parties and to which the North Carolina Attorney General and Nantahala's customers were parties. The FERC determinations were upheld by the United States Court of Appeals for the Fourth Circuit. *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342 (4th Cir. 1984). Now the North Carolina authorities have superseded the federal findings and set Nantahala's rates in a manner that directly contradicts them, not only giving Nantahala's customers priority with respect to all the inexpensive hydropower in the region, but imposing a direct financial burden on a customer located in Tennessee. As a result the economy of East Tennessee is threatened with severe dislocations.

The State of Tennessee, as amicus curiae, would emphasize these facts to this High Court and assert that the actions of North Carolina and its Utilities Commission violate both the Commerce Clause, U.S. CONST., Art. I, § 8, and the Federal Power Act, 16 U.S.C. § 791 et seq.

II.

THE NORTH CAROLINA DECISION VIOLATES THE COMMERCE CLAUSE BY INTERFERING WITH THE DISTRIBUTION OF ELECTRICITY BETWEEN STATES.

The decision of the North Carolina tribunals interferes with interstate commerce in order to further the interests of that State at the expense of its neighboring states. It seeks to restrict to North Carolina the benefits

of low-cost power generated in the mountains along the North Carolina-Tennessee border. It denigrates any claim to a part of the hydropower that might be asserted by Tennessee or other states. Electricity, however, is an item in commerce that cannot be hoarded by one state. The Commerce Clause gives all Americans access to our scarce resources and prevents any state from sealing itself off from the national economy.

The decision below does not physically prevent the flow of electric current, but its economic effect is exactly the same. It amounts to a burden on the transfer of power from North Carolina to Tennessee, since it reassigns the benefits of low-cost hydropower from Tapoco's customer in Tennessee to Nantahala's customers in North Carolina. The decision thus directly conflicts with *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982). In that case New Hampshire did not prevent the flow of power across its border, but it set retail rates as if hydropower exported to other states had been consumed in New Hampshire. This Court struck down New Hampshire's efforts, holding its actions to constitute a burden on commerce. The instant case fits into the same category.

A similar approach has recently been adopted by the Eighth Circuit in *Middle South Energy, Inc. v. Arkansas Public Service Commission*, 772 F. 2d 404 (8th Cir. 1985). In that matter the FERC had allocated power and associated costs among related utilities in four states. Those included the high cost of a nuclear power plant. Arkansas tried to reject those costs in setting retail rates, so its consumers would bear none of the nuclear plant costs. The Eighth Circuit held that Arkansas had contravened the

Commerce Clause since it gave its citizens a preference over those of other states.

The North Carolina decision expressly is designed to further the best interest of the customers of Nantahala, all of whom are North Carolinians. It gives those customers a preference on all the electric energy output of the combined systems of Nantahala and Tapoco. *See North Carolina ex rel. Utilities Commission v. Edmisten*, 299 N.C. 432, 435, 263 S.E.2d 583, 586 (1980); Appendix to Jurisdictional Statement at 183a. It ignores the countervailing interests and needs of Tennessee. It represents precisely the sort of burden on commerce that the Constitution prohibits. *See Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

Indeed, the decisions below give the customers in North Carolina preference with respect to all the cheap power, both that generated in North Carolina and that generated in Tennessee. Under their reasoning, as Nantahala's load grows, Tennessee in a few years will receive none of the hydroelectric power. North Carolina has thus instituted a blatantly protectionist policy that significantly impedes the flow of electric power in interstate commerce. By so doing it has infringed the Commerce Clause. Tennessee contends that this Court should act in the interest of the national economy and ensure the rights of Tennessee and other states to an unimpeded power supply.

III.

THE NORTH CAROLINA DECISION INFRINGES THE FEDERAL POWER ACT BY REJECTING COSTS ESTABLISHED BY FERC.

The Federal Power Act contemplates that the FERC will regulate the sale and transmission of electricity among the several states and establish wholesale power costs. The states are then to include these costs in determining retail rates for the domestic utilities which they regulate. Under the "filed rate" doctrine, state commissions must treat the rates fixed by the FERC as reasonable operating expenses for all purposes. *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951). This does not prevent a state commission from finding that increases in FERC-approved rates are offset by savings in other facets of the utility's operations. It does mean, however, that the rates set by FERC are the foundation of any such calculations of retail rates. Nevertheless, the decision below has rejected the FERC's determinations about Nantahala's power costs and has reconsidered all aspects of its operations, reaching conclusions diametrically opposed to those of FERC when it considered the same matters. Such flouting of the rate schedules established by FERC cannot be tolerated under the Federal Power Act.

Under the approach adopted by the North Carolina Supreme Court, the Utilities Commission in that state may wholly disregard FERC's determinations and decide for itself that electricity arrangements between states are unreasonable. It may then refuse to permit local utilities to recover the costs they incur under FERC's wholesale rate schedules. While the decision below does not propose

to overturn the FERC's decision, its result is exactly that. The costs that consequently are not then covered by the North Carolina rates are shifted to consumers in other states.

The absurdity of the North Carolina view is best illustrated by supposing the Tennessee Public Service Commission might take the same approach and decide Tapoco's rates are too high and that Tennessee should have first call on all the inexpensive hydropower.[2] Tennessee clearly has authority to regulate the retail sale of power by Tapoco to Alcoa, just as North Carolina may regulate the retail sale of power by Nantahala to its customers. Tennessee law vests this regulatory authority in the Tennessee Public Service Commission. TENN. CODE ANN. §§ 65-4-104, 65-4-116. Indeed, the instant record shows that the Public Service Commission has previously asserted its right to control such rates. *See* Exhibit T-5, Opinion and Order of Tennessee Public Service Commission re Construction of Chilhowee Dam, Decretal Paragraph 1(a). If the Public Service Commission should choose to ignore the FERC and proceed along the same lines as the North Carolina Utilities Commission by allotting virtually all the power of both utilities to Tennessee an impasse would result. This would leave both Tapoco and Nantahala (as well as their parent Alcoa) in limbo, since neither could recover its cost of service, and both might be unable to serve their customers.

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[2] The history of the development of hydropower in the Southern mountains and the allocation thereof might well be viewed as giving Tapoco a far better claim to the cheap power than Nantahala or any North Carolina interests.

The role of FERC in power regulation at the wholesale level is inconsequential if its determinations do not carry through to influence retail rates. For this reason many courts have held that state commissions must provide for FERC-approved wholesale charges in establishing retail rates. *See Washington Gas Light Co. v. Public Service Commission*, 452 A. 2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). This obviously means that the states may not reexamine FERC's wholesale cost allocations, but must accept them at face value and incorporate them in their decision-making. *See Northern States Power Co. v. Minnesota Public Service Commission*, 344 N.W. 2d 374 (Minn.), *cert. denied*, — U.S. —, 104 S.Ct. 3546 (1984); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Office of Public Counsellor v. Indiana & Michigan Electric Co.*, 416 N.E.2d 161 (Ind. App. 1981).

These issues were examined in the recent opinion of the New Hampshire Supreme Court in *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985). There the court held that FERC approval of a wholesale rate precludes a state from questioning the reasonableness of that charge. The court observed that the correct approach

> is to examine those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved. (emphasis in original)

498 A.2d at 704. Thus any state determinations must not call FERC decisions into question and are required to

preserve the integrity of the FERC rate. *See also Pike County Light & Power Co. v. Pennsylvania*, 465 A.2d 735 (Pa. Commw. Ct. 1983).

Here the effect of the decision below is to overturn a FERC decision by contradicting at many points its findings in approving the agreements and schedules affecting Nantahala. The approach used by the North Carolina Commission was to "roll-in" the power supplies and costs of Nantahala and Tapoco as if they were one system, and then to allocate to Nantahala the lion's share of low-cost power, leaving only a minimal amount for Tapoco. Under this approach, and if current trends continue, within approximately eight years Tapoco will be allotted no hydroelectric power. This is directly contrary to FERC's determination that the wholesale rate schedules between the parties are fair to all concerned. This unilateral action of North Carolina has left Tennessee without any voice in the decision-making process and has nullified the authority of the FERC in North Carolina. Such blatant violation of both the letter and the intent of the Federal Power Act cannot be tolerated by this High Court.

IV.

THE DECISION BELOW IS FUNDAMENTALLY AT VARIANCE WITH OUR FEDERAL SYSTEM.

The decision of the North Carolina tribunals is an affront to Tennessee's sovereignty and the comity that ought to exist between neighboring states. The regulation of interstate commerce in instances such as this was a paramount reason for the creation of the Federal Union and the Constitution. This Court ought to review such a blatant

attempt by a state to gather unto itself scarce economic resources at the expense of its sister state, and without allowing that sister state a role in the decision-making process.

This case is of great, immediate importance to the economy of Tennessee. It is of even greater precedential importance to the electric power industry and to regulatory commissions in other states, many of which are being tempted to ignore FERC cost allocations and give their constituents preference in distributing scarce economic resources. Only this Court can protect the Federal Power Act and preserve the unified national market in such resources envisioned by the framers of the Commerce Clause.

The North Carolina Court has held that a state may examine interstate power allocations and set retail rates wholly without regard for the allocation of wholesale costs made by the FERC. It has rendered the FERC determination in the instant case meaningless. Should each state adopt a similar approach and give its own residents preference in electrical entitlements, the entire system of interstate wholesale power transmission would disintegrate into chaos and petty rivalries. The notion that a state utility commission may ignore FERC-approved wholesale costs in setting local retail power rates would gut the Federal Power Act and disrupt interstate commerce in electricity.

North Carolina claims that its Utilities Commission has merely set intrastate retail rates and, in doing so, pierced the corporate veils among Alcoa, Tapoco, and Nantahala because of the parent Alcoa's misdealings. This finding, however, inevitably involves the same issues decided by the FERC in approving the rate schedules involving these utilities. In reconsidering these matters, North

Carolina necessarily substitutes the judgment of its Commission for that of the federal Commission. This it lacks the power to do.

The purpose of the Federal Power Act is to create an impartial federal forum for determination of the sort of interstate controversies and allocations that the North Carolina Commission seeks to scrutinize. As this case abundantly demonstrates, the agencies of one state simply cannot make fair and impartial decisions between citizens of that state and claimants in other jurisdictions. There is an inherent conflict of interest, particularly since the state tribunal is selected by and accountable to the citizens of that state who are parties to such a dispute, and not by the opposing side.

This is further illustrated by the origins of this case as a North Carolina ratemaking proceeding. No party in that proceeding directly represented the interests of Tennessee and its citizens. Indeed, no such concerns of another state would be present in a truly intrastate ratemaking proceeding. The "roll-in" device, however, transformed this case into far more than its origins would indicate. In such state proceedings, the agency members can scarcely be expected to balance fairly the interests of another state.

Upon learning of the peculiar ruling of the North Carolina Commission, Tennessee did attempt to express its concerns to the appellate courts of that state. Tennessee was rebuffed, however, when the Court of Appeals of North Carolina, on December 2, 1982, denied a motion filed by Tennessee for leave to file an amicus curiae brief. While

the Supreme Court of North Carolina later permitted Tennessee to file an amicus brief, it is obvious that Tennessee's interests were hardly taken into account in a context in which Tennessee was uncertain if the courts of North Carolina would even permit its voice to be heard. In its brief to this Court supporting the motion to dismiss or affirm, the Town of Highlands, North Carolina disputed Tennessee's assertion that it had had no opportunity to participate in the decisions below, noting the filing of the amicus brief. (Brief at 2-3 n.3). Such "opportunity", at such a late date, without status as a party, and after rejection of a previous amicus brief, hardly approaches the role Tennessee ought to have from the very inception of a decision that severely impacts its economy and could leave thousands of its citizens unemployed. Tennessee has its proper forum before the FERC; it clearly did not have a forum for its interests in North Carolina.

It is obvious that one state ought not dictate to another the most fundamental decisions affecting that state's economy and resources. The federal Constitution was designed to prevent just such conflicts between states. Congress has effectuated that design by enacting the Federal Power Act, which removes decisions of interstate magnitude from state authority and places them before the FERC, an impartial federal authority.

Tennessee submits that North Carolina must not be permitted to frustrate the Constitution, the intent of Congress, and the role of the FERC by disguising this case as a local ratemaking matter. This High Court ought to vindicate the rights of Tennessee and its citizens and to restrict the North Carolina decision-makers to truly intrastate matters. It can do so by requiring that state's Commission to set Nantahala's rates only after taking fully into account the allocation of power and costs determined by the FERC.

The decision below has spurned the authoritative and impartial decisions of the FERC with regard to Nantahala's wholesale power supply arrangements. It has violated the sovereignty of Tennessee and robbed that state of its fair and historic share of hydropower. It threatens to result in the closing of one of Tennessee's largest and best employers. Thus the North Carolina decision not only violates the sovereignty and comity due Tennessee, but it also portends the economic collapse of a prosperous region and accompanying massive unemployment in Tennessee's tenth largest county. In so doing the North Carolina decision flies in the face of the Constitution, the Federal Power Act, the decision of the FERC, and the case authorities cited in this and appellants' brief. It therefore must be reversed.

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CONCLUSION

For these reasons, the State of Tennessee submits that the decision of the North Carolina Supreme Court should be reversed and remanded with instructions that the North Carolina authorities set Nantahala's rates with due and full regard for the allocations of power and costs made by the FERC.

Respectfully submitted,

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